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Private Company Services

In this issue:  
**Flocking south to purchase a U.S. vacation property**  
**Harmonized sales taxes - crystal clear or clear as mud?**  
**Get a GRIP on extra cash before 2010**  
**A lack of trust**

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## Privately Speaking

### Tax Insights

Income tax in Canada is constantly changing. New legislation, daily pronouncements from the Canada Revenue Agency (CRA) and evolving case law all contribute to a tax planning environment that requires continual review and revision. We want to keep you up to date on timely and relevant tax matters that impact your life and your business. *Privately Speaking — Tax Insights* will serve as the medium to provide ideas and guidance to Canadian private companies, their employees and their shareholders on such tax matters. My Private Company Services (PCS) colleagues from across Canada have contributed four articles to this issue. I invite you to share this newsletter with your staff and associates who may be interested in purchasing a U.S. vacation property, understanding harmonized sales taxes, appreciating the timely payment of eligible dividends, and learning about the CRA's recent audit project involving family trusts.

The authors, our editorial team (noted in the margin) and your local contacts are all pleased to discuss these issues or any other tax matters that concern you. Please feel free to contact any one of us.

Enjoy the newsletter,



*Jim MacGowan, National Tax Leader, Private Company Services*

### **Flocking south to purchase a U.S. vacation property**

*By Christina Diles and Chantal Baril*

With a strong Canadian dollar and U.S. real estate prices being ravaged by the financial crisis, many Canadians have headed to the southern U.S. states to purchase a vacation home. However, Canadians should be aware of certain issues prior to making this investment decision. Among these are:

- U.S. personal income tax filing requirements
- U.S. estate taxation that may arise if U.S. real estate and other assets located in the U.S. are owned at death

Regardless of where you live in Canada, income resulting from a personally-owned U.S. vacation property that is rented or sold must be reported on a U.S. personal income tax return. While the requirement to file a U.S. personal tax return will result in an increased administrative burden, your total tax bill should not generally be increased, as any U.S. income tax owing will typically be creditable as a foreign tax credit on your Canadian income tax return.

### **Can the U.S. tax a Canadian's estate?**

Unlike Canada, which taxes the increase in value of property owned on death as a capital gain, the U.S. imposes an estate tax which is calculated as a percentage of the value (and not the capital gain) of certain assets owned at the time of death. Current U.S. estate tax rates can be as high as 45%.

Individuals domiciled in the U.S. are subject to U.S. estate tax on the fair market value of their worldwide assets, while others (like Canadians who live primarily in Canada) are subject to U.S. estate tax on the value of their assets located in the U.S. upon death. In the latter case, the ownership structure of the assets can significantly impact the imposition of the U.S. estate tax.

For example, a Canadian owning U.S. real estate personally would generally be considered as owning a U.S.-situs asset which would be included in the taxable estate of the deceased Canadian. Acquiring the real estate in joint tenancy may result in undesirable U.S. estate tax as well as potential U.S. gift tax issues, unless each joint tenant can prove that they contributed to the purchase of the property.

### **Planning to protect your heirs**

One U.S. estate tax planning strategy involves establishing a Canadian resident discretionary trust to acquire the U.S. vacation property. This strategy is suited to high net-worth individuals who wish to transfer U.S. real estate to their spouse and/or children on their death and who can therefore be identified as beneficiaries of the trust. If properly structured, the estate tax would be deferred until the death of the beneficiaries.

Other strategies to reduce or defer the impact of the U.S. estate tax at death involve a non-recourse mortgage and life insurance. However, the historical tried and true approach of using a Canadian company to acquire U.S. real estate for personal use is not usually the best strategy any longer.

It may be hot in states like Florida and Arizona, but don't get burned. Prior to falling in love with your future sunshine escape, seeking guidance on structuring your U.S. real estate ownership affairs is crucial before you start to enjoy your southern comfort.

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[Back to top](#)

## Harmonized sales taxes — crystal clear or clear as mud?

By Lisa Zajko

Economists and politicians have kindly lent us their pontifications about the harmonized sales tax (HST) regimes imminent in Ontario and B.C. And Canadians so appreciate the perfect clarity presented by leaders on this topic that they are breathing a collective sigh of "huh?"

While harmony may be absent, Deloitte is committed to bringing true clarity to the complex new tax regime, which will certainly have its winners and losers.

Few consumers are feeling like winners, as the tax on most services and some goods will increase by 7% in B.C. and 8% in Ontario under the HST. However, these same consumers have long been paying for embedded costs that will be virtually eliminated under the HST. A study in the Atlantic provinces, several of which have implemented HST's of their own, indicates that savings and benefits reaped by businesses will eventually be passed on to consumers.

Some other basic truths about the HST:

- Value-added taxes (VAT) similar to the proposed HST have long been in place around the world, not to mention Atlantic Canada and Quebec.
- VAT's have been gaining favour in part because they avoid the cascading effect of sales tax by taxing only the value added at each stage of production and distribution.
- Unfortunately, doctors, insurers and other organizations that make exempt supplies will generally experience higher costs due to increased non-refundable taxation on expenditures for services (e.g. consulting, accounting, etc.) and office rent.
- Harmonization in Ontario and B.C. intensifies pressures on the remaining hold-out provinces, Manitoba, Saskatchewan, and P.E.I., to follow suit.

Harmonization will undoubtedly reduce costs for most businesses through removal of the embedded provincial sales tax in purchases, reduced paperwork or filings and improved efficiencies of dealing with only one level of government on audit. As an added benefit, the C.D. Howe Institute predicts that, in Ontario at least, harmonization will lower the province's overall effective tax rate on investment to 22% from 35% by 2012.

In the meantime, the following are some tips for minimizing the negative effects of the HST, at least in the short term:

### For business owners

- Though not always practical, consider deferring the purchase of goods that are subject to PST until July 1, 2010.
- Consider leasing goods with a post July 1, 2010 buy-out option.
- For very large or substantial acquisitions, there is some indirect-tax planning available that can reduce the amount of PST.

## For consumers

- On your next real estate transaction, consider the re-sale market to avoid the HST. Also, know that the HST will apply to any costs and fees associated with your home or property purchase, including legal fees, commissions, and other closing costs. While there are rebates for new-home purchases up to a certain cap, the HST impact will not be insignificant.
- As pre-payments after May 1, 2010 will generally be subject to the HST, start planning your next major vacation in time to ensure that payment can be made before the end of April. Alternatively, pre-pay your round-trip journey before July 1, 2010 so long as you plan to leave on your continuous journey before that date.
- For golf, gym or other recreational memberships, the same pre-payment rules hold true with one exception: if you plan to buy a lifetime membership, be aware that HST will be owing on the portion of the membership fee that exceeds 25% of the cost, even if the membership is paid before May 1, 2010. Furthermore, when your golf club's finance committee is setting monthly dues, be sure to mention the savings that they will enjoy on their purchased seed, chemicals, mowers, and other inputs.
- Where possible, purchase or update your annual subscription to *Maclean's*, *Fortune*, *The Economist* and other periodicals before July 1, 2010.
- And, finally, in a world where arguably nothing is certain but death and taxes, it may be just a little ironic that taking the time to plan and pay for your funeral services and burial plot before July 1, 2010 will keep some tax dollars in your pocket.

There are few issues about which public debate serves to decrease, rather than increase, public understanding; to the list that included particle physics, macroeconomic forecasting and understanding the source of Paris Hilton's fame, we can now add harmonized tax regimes. It is our hope that this article has brought true clarity to at least one of these issues. After all, harmonization is plainly here to stay.

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[Back to top](#)

## Get a GRIP on extra cash before 2010

*By Stefan Mihailovich*

"A bird in the hand is worth two in the bush," goes the old saying. This conservative approach to life not only speaks volumes during this period of financial turmoil, but can also translate into big bucks for your wallet today!

As we approach the end of another calendar year, thoughts turn to traditional year-end tax planning. This is a time when we take stock of our personal tax situation and, with one eye on the new year, take those actions that will accelerate tax deductions or defer income inclusions in 2009. But wouldn't you know it - this year there's another issue to consider.

In conjunction with phased-in lower corporate tax rates, a corresponding increase in the personal tax rate on eligible dividends will occur after 2009 in all provinces other than New Brunswick.

#### Summary of increasing tax rate on eligible dividends by province

Province	Eligible dividend top tax rates			
	2009	2010	2011	2012
Alberta	14.55%	15.88%	17.72%	19.29%
British Columbia	19.92%	21.45%	23.91%	26.11%
Manitoba	23.83%	25.09%	26.74%	28.12%
New Brunswick	21.80%	19.46%	19.77%	21.16%
Newfoundland and Labrador	22.89%	24.37%	26.68%	28.75%
Northwest Territories	18.25%	19.81%	22.33%	24.61%
Nova Scotia	28.35%	29.80%	32.00%	33.94%
Nunavut	22.24%	23.64%	25.72%	27.56%
Ontario	23.06%	26.57%	28.19%	29.54%
Prince Edward Island	24.44%	25.95%	28.36%	30.50%
Quebec	29.69%	30.68%	31.85%	32.81%
Saskatchewan	20.35%	21.64%	23.36%	24.81%
Yukon	17.23%	18.80%	21.34%	23.64%

Eligible dividends are dividends paid from a corporation's General Rate Income Pool (GRIP). In simple terms, a corporation's GRIP is the accumulation of after-tax corporate income that has been taxed at the general corporate tax rate. Generally, this means active corporate income that is not eligible for the small business deduction (SBD) or that is in excess of the SBD (i.e., in excess of \$500,000).

To pay an eligible dividend you must know your corporation's GRIP balance, a calculation that can be complex and may require professional assistance. However, it is important to calculate the GRIP balance now to determine whether your corporation is able to pay an eligible dividend and whether, after reviewing all tax and non-tax considerations, it is prudent to pay an eligible dividend before the end of 2009 to take advantage of today's lower personal tax rate. For example, a top tax-rate resident of British Columbia could save over \$12,000 if a \$200,000 eligible dividend was paid in 2008 versus 2012.

Any GRIP balance you don't distribute now will still be available to you, albeit at a higher tax cost to you. However, in some provinces, if you factor in today's highly discounted time value of money versus the tax savings, you may want to pay dividends now rather than later.

There you have it, another year-end tax planning consideration. Calculate your company's GRIP balance and decide whether it makes sense to pay yourself an eligible dividend before December 31, 2009. Is a bird in the hand worth two in the bush? Well, that's for you to decide.

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[Back to top](#)

## A lack of trust

*By Charles Fu*

The CRA plans to audit *inter vivos* trusts. Their main targets are trusts established to facilitate income-splitting with lower income spouses and children. The CRA will primarily focus on three issues:

1. Has the trust issued promissory notes to beneficiaries? Trust beneficiaries are frequently paid through the issuance of a promissory note. In certain circumstances, these notes may be viewed as being legally unenforceable, which could result in unintended and adverse tax consequences for the trust and/or beneficiaries.
2. Has the trust deducted any amounts withdrawn by trustees for their own use? The CRA may challenge the deduction to the trust or assess a taxable benefit to the trustees (usually the parents).
3. Are proper accounting records, trustee minutes and the original settlement property readily available? The CRA may disallow expenses or beneficiary allocations that cannot be supported.

Timely action is critical. With the CRA's lack of trust in the tax compliance history and records of *inter vivos* family trusts, an audit of your family trust may be imminent. We would be pleased to assist you to ensure that your trust is in order.

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[Back to top](#)

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